

## Message Text

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PAGE 01 SEOUL 00334 160534Z

21

ACTION EA-14

INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-07 H-03 INR-10 L-03

NSAE-00 NSC-10 PA-04 RSC-01 PRS-01 SPC-03 SS-20

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R 160436Z JAN 74

FM AMEMBASSY SEOUL

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INFO AMEMBASSY TOKYO UNN

AMCONSUL HONG KONG UNN

C O N F I D E N T I A L SEOUL 334

E.O. 11652: GDS

TAGS: EGEN, KS

SUBJECT: COMMENT ON NEW ECONOMIC MEASURES

REF: A. SEOUL 322; B. CERP

SUMMARY: NEW ECONOMIC MEASURES REPRESENT FIRST STEP IN NEW ROKG STRATEGY TO ATTEMPT TO OVERCOME PROBLEMS OF RAPID INFLATION DURING FIRST HALF OF 1974 SO THAT STABILIZATION CAN BE EMPHASIZED IN SECOND HALF. POLITICAL SITUATION UNDOUBTEDLY INFLUENCED CONTENT AND TIMING OF MEASURES SELECTED. CURRENT OUTLOOK IS FOR 8 PERCENT GNP GROWTH IN 1974 ACCOMPANIED BY INCREASED TRADE DEFICIT AND INCREASED NEED FOR PUBLIC AND PRIVATE U.S. CAPITAL. END SUMMARY

1. ALTHOUGH SERVING POLITICAL PURPOSES AND TIMED TO OFFSET GOVERNMENT'S REPRESSIVE POLITICAL ACTIONS, NEW ECONOMIC MEASURES DESCRIBED REFTEL HAVE BEEN IN PROCESS FORMULATION NEARLY TWO MONTHS, EVER SINCE RAPID INFLATION AND OTHER EFFECTS OF WORLD OIL SHORTAGE BECAME APPARENT. MEASURES ARE PART OF STRATEGY AIMING AT QUICK  
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PAGE 02 SEOUL 00334 160534Z

ADJUSTMENT TO HIGHER OIL AND OTHER PRICES. BY CUSHIONING EFFECTS

OF RECENT AND PROSPECTIVE PRICE INCREASES, TAX BREAKS NOT ONLY DEMONSTRATE CONCERN FOR SOCIAL EQUALITY BUT SHOULD HELP MODERATE INEVITABLE WAGE INCREASES. INCREASES IN LUXURY TAXES NOT ONLY HAVE "REVITALIZING" FLAVOR BUT SET TONE FOR AUSTERITY THAT MAY BE REQUIRED OF ALL LATER IN YEAR. NEW TARGET OF BUDGET SURPLUS NOT ONLY JUSTIFIES MORE LIBERAL CREDIT POLICIES BUT IS PRECAUTION AGAINST LOWER REVENUES IN EVENT OF ECONOMIC SLOWDOWN.

2. NEW MEASURES WILL BE FOLLOWED SHORTLY BY ANNOUNCEMENT OF SUBSTANTIAL OIL AND OTHER PRICE HIKES. GOVERNMENT ECONOMISTS EXPECT ADDITIONAL 15 PERCENT INCREASE IN WHOLESALE PRICE INDEX IN FIRST FEW MONTHS OF 1974, AFTER 15.1 PERCENT INCREASE DURING 1973. ROUGH ESTIMATE FOR ALL OF 1974 IS 25 PERCENT. (SEOUL CONSUMER PRICE INDEX ROSE 7.3 PERCENT DURING 1973 WITH HALF OF GAIN OCCURRING IN LAST TWO MONTHS.) WHEN NEW PRICE INCREASES ARE ANNOUNCED, WE UNDERSTAND GOVERNMENT WILL TAKE PERMISSIVE ATTITUDE TOWARD WAGE INCREASES THAT ARE IN LINE WITH COST OF LIVING AND PRODUCTIVITY INCREASES. ACCORDING TO GOVERNMENT OFFICIALS HIGHER LEVEL OF UNION ACTIVITIES WILL BE TOLERATED, BUT WAGE INCREASES WILL REMAIN CONTROLLED AND DISPUTES SETTLED BY COMPULSORY ARBITRATION. GOVERNMENT OFFICIALS HOPE THAT, AFTER WAVE OF LARGE PRICE AND WAGE INCREASES, RELATIVE STABILITY CAN BE ACHIEVED IN SECOND HALF. THEY EXPECT COMPARABLE INFLATION IN JAPAN AND TAIWAN, POINTING TO WHOLESALE PRICE INCREASES OF ABOUT 30 PERCENT DURING 1973.

3. WHILE DETAILS OF OFFICIAL ECONOMIC FORECAST (ORB) FOR 1974 NOT YET COMPLETED, GOVERNMENT HOPES FOR 8 PERCENT REAL GROWTH IN GNP. HOWEVER, HIGHER OIL AND OTHER IMPORT PRICES WILL CAUSE INCREASED TRADE DEFICIT WHICH ROKG HOPES TO COVER WITH INCREASED LONG-TERM CAPITAL INFLOWS. IN PREVIEW OF NEW MEASURES AND 1974 OUTLOOK, EPB VICE MINISTER LEE JAE SUL EMPHASIZED HOPES THAT U.S. PUBLIC AND PRIVATE INFLOWS CAN BE INCREASED IN 1974 TO OFFSET EXPECTED DECLINE IN JAPANESE INFLOWS AS RESULT OF JAPANESE ECONOMIC DIFFICULTIES AND REDUCED AID. LEE REITERATED IMPORTANCE, FOR BUDGETARY AS WELL AS BALANCE OF PAYMENTS REASONS, OF RESUMING PL 480 SALES AND OF PROVIDING \$35 MILLION IN MAP O & M ORIGINALLY REQUESTED FOR FY 1974.

4. LEE INDICATED NO SIGNIFICANT CHANGES WILL BE MADE NOW IN 1973-81 HEAVY AND CHEMICAL INDUSTRY PLAN ANNOUNCED LAST SPRING, SINCE

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PAGE 03 SEOUL 00334 160534Z

CONDITIONS TOO UNSETTLED FOR LONG-TERM DECISIONS. SHORT-TERM PRIORITY WILL BE GIVEN TO COMPLETING THE VERTICAL INTEGRATION OF THE PETROCHEMICAL INDUSTRY.

5. LEE ALSO INDICATED THAT ROKG HOPES TO HOLD GRAIN MANAGEMENT FUND DEFICIT TO MAGNITUDE OF BUDGET SURPLUS SO AS TO ACHIEVE OVERALL FISCAL NEUTRALITY. COSTLY WHEAT FLOUR SUBSIDY WILL BE REDUCED OR TERMINATED. DOMESTIC CREDIT WILL NOT BE RESTRICTED SHARPLY IN

FIRST HALF, SO AS TO FACILITATE ADJUSTMENTS TO INFLATION AND POSSIBLE SHORTAGES AND WEAK EXTERNAL DEMAND (E.G. IN TEXTILES) BUT WILL BE TIGHTENED IN SECOND HALF. ALL FINANCIAL MEASURES WILL BE REVIEWED WITH IMF TEAM NOW SCHEDULED ARRIVE IN MID-FEBRUARY TO NEGOTIATE NEW STANDBY AGREEMENT.

6. IN POLITICAL TERMS, THESE MEASURES REPRESENT ATTEMPT TO SOFTEN IN ADVANCE PUBLIC IMPACT OF RAPID INCREASE IN COST OF LIVING. THEY ARE ALSO EFFORT TO REBUILD POPULAR SUPPORT AND TO SHIFT PUBLIC ATTENTION AWAY FROM EMERGENCY POLITICAL MEASURES BY A SHOW OF GOVERNMENTAL CONCERN WITH SOCIAL/ECONOMIC PROBLEMS.  
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